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FOR REVIEW

TERRACE GARDENS, INC.
(A California Nonprofit Public Benefit Corporation)

ANNUAL FINANCIAL REPORT

DECEMBER 31, 2002 AND 2001

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Terrace Gardens, Inc.

We have audited the accompanying statement of financial position of Terrace Gardens, Inc., a California Nonprofit Public Benefit Corporation, as of December 31, 2002 and 2001, and the related statements of activities and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Terrace Gardens, Inc. at December 31, 2002 and 2001, and the results of its operations and its cash flows for the years then ended, in conformity with generally accepted accounting principles generally accepted in the United States of America.

The supplementary information on future major repairs and replacements on page 14 is not a required part of the basic financial statements but is supplementary information required by the American Institute of Certified Public Accountants. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Milpitas, California

February 21, 2003

TERRACE GARDENS, INC.
STATEMENTS OF FINANCIAL POSITION

December 31, 2002 and 2001

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	<u>2002</u>	<u>2001</u>
<u>ASSETS</u>		
PROPERTY		
Land	\$ 1,565,277	\$ 1,565,277
Buildings and Improvements	11,601,281	11,576,526
Furnishings and equipment	277,859	274,030
Less: Accumulated Depreciation	<u>(3,424,340)</u>	<u>(3,167,268)</u>
Net property	10,020,077	10,247,565
OTHER ASSETS		
Cash - unrestricted operating	(18,203)	3,374
Cash - restricted		
Tenant security deposits	77,010	74,991
Short-term reserves	400,000	400,000
Long-term reserves	400,000	400,000
Operating reserves	151,361	379,003
Carillon fund	926	916
Construction deficit reserve	2,819	2,790
Tenants rents receivable	3,269	151
Deposits - Worker's Comp	1,704	1,704
Prepaid taxes	0	2,575
Prepaid insurance	<u>42,774</u>	<u>34,391</u>
TOTAL ASSETS	<u><u>11,081,737</u></u>	<u><u>11,547,460</u></u>
<u>LIABILITIES AND NET ASSETS</u>		
LIABILITIES		
Accounts payable - trade	76,541	108,729
Accrued vacation	11,780	6,079
Tenant security deposits, including interest	77,273	75,135
Prepaid rents	904	70
Total Liabilities	<u>166,498</u>	<u>190,013</u>
NET ASSETS - UNRESTRICTED	<u>10,915,239</u>	<u>11,357,447</u>
TOTAL LIABILITIES AND NET ASSETS	<u><u>11,081,737</u></u>	<u><u>11,547,460</u></u>

See accompanying notes to these financial statements.

TERRACE GARDENS, INC.

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STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS

For the years ended December 31, 2002 and 2001

	<u>2002</u>	<u>2001</u>
Income		
Gross potential rent	\$ 805,781	\$ 790,225
Guest rentals	5,540	6,460
Less vacancy loss	<u>(9,599)</u>	<u>(4,016)</u>
Net rental income	801,722	792,669
Interest income	30,328	70,742
Food service income	301,572	258,987
Other income	<u>3,115</u>	<u>7,100</u>
Total income	1,136,737	1,129,498
Operating expenses		
Administrative expense	199,831	212,528
Utilities	149,441	125,382
Operating and maintenance	372,523	221,610
Taxes and insurance	163,448	133,594
Food service contract	371,148	357,331
Recreation	<u>65,482</u>	<u>50,394</u>
Total operating expenses	1,321,872	1,100,839
Depreciation	257,072	251,799
Total expenses	1,578,944	1,352,638
Decrease in net assets	(442,208)	(223,140)
Unrestricted net assets - Beginning of year	11,357,447	11,580,587
Unrestricted net assets - End of year	<u>10,915,239</u>	<u>11,357,447</u>

See accompanying notes to these financial statements.

TERRACE GARDENS, INC.

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STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS (Continued)

For the years ended December 31, 2002 and 2001

	2002	2001
<u>Administrative expenses</u>		
Advertising	\$ 2,110	\$ 4,687
Office Salaries	53,894	62,363
Office Supplies	18,502	17,236
Management fee	46,240	43,764
Manager's salary	49,652	44,398
Audit fee	4,000	4,173
Legal & Accounting	13,583	17,097
Telephone and answering service	8,555	7,808
Seminars and training	1,460	1,815
Miscellaneous administrative	1,835	9,187
Total administrative expenses	<u>\$ 199,831</u>	<u>\$ 212,528</u>
<u>Utilities</u>		
Electricity	94,149	69,637
Water	37,173	27,606
Gas	11,172	18,116
Sewer	6,947	10,023
Total utilities	<u>\$ 149,441</u>	<u>\$ 125,382</u>
<u>Operating and maintenance</u>		
Janitor payroll	43,114	41,607
Janitor and cleaning	17,838	15,814
Exterminating	7,431	6,847
Trash removal	18,226	17,645
Security	8,573	3,256
Grounds contract and supplies	20,114	27,665
Repairs payroll	72,886	63,981
Repairs materials	13,818	16,626
Repairs contracts	146,309	3,456
Plumbing maintenance	1,965	1,555
Electrical maintenance	1,252	-
Elevator maintenance	9,321	8,746
Heating and cooling repairs	10,020	10,134
Painting contract and supplies	1,655	4,278
Total operating and maintenance	<u>\$ 372,523</u>	<u>\$ 221,610</u>

See accompanying notes to these financial statements.

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TERRACE GARDENS, INC.

STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS (Continued)

For the years ended December 31, 2002 and 2001

	<u>2002</u>	<u>2001</u>
<u>Taxes and Insurance</u>		
Real estate taxes - special assessments only	\$ 8,636	\$ 4,972
Payroll taxes	22,218	22,065
Miscellaneous licenses and permits	443	80
Property and liability insurance	78,824	69,454
Workers' compensation	23,770	20,276
Health Insurance and other employee benefits	29,559	16,747
Total taxes and insurance	<u>\$ 163,448</u>	<u>\$ 133,594</u>
 <u>Food service contract</u>		
Food	371,148	357,331
Total food service contract	<u>\$ 371,148</u>	<u>\$ 357,331</u>
 <u>Recreation expense</u>		
Salary	31,357	22,658
Supplies	13,955	9,135
Service coordinator salary	14,394	13,884
Miscellaneous recreation expense	5,775	4,717
Total recreation expense	<u>\$ 65,482</u>	<u>\$ 50,394</u>

See accompanying notes to these financial statements.

TERRACE GARDENS, INC.
STATEMENTS OF CASH FLOWS

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For the years ended December 31, 2002 and 2001

	<u>2002</u>	<u>2001</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Decrease in net assets	\$ (442,208)	\$ (223,140)
Adjustments to reconcile decrease in net assets to net cash provided by operating activities:		
Depreciation	257,072	251,799
Decrease / (Increase) in current assets		
Tenant rents receivable	(3,118)	1,078
Prepaid insurance and taxes	(5,808)	(5,998)
Increase / (Decrease) in current liabilities		
Accounts payable	(32,188)	41,048
Prepaid rents	834	(32)
Security deposits	2,138	(456)
Accrued vacation	5,701	595
Net cash provided by operating activities	<u>\$ (217,577)</u>	<u>\$ 64,894</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Building Improvements	(25,755)	(113,433)
Property & equipment additions	(3,829)	(21,809)
Restricted cash accounts	<u>225,584</u>	<u>53,023</u>
Net cash used in investing activities	<u>\$ 196,000</u>	<u>\$ (82,219)</u>
INCREASE / (DECREASE) IN UNRESTRICTED CASH	<u>\$ (21,577)</u>	<u>\$ (17,325)</u>
UNRESTRICTED CASH AT BEGINNING OF YEAR	3,374	20,699
UNRESTRICTED CASH AT END OF YEAR	<u>\$ (18,203)</u>	<u>\$ 3,374</u>

See accompanying notes to this financial statement.

TERRACE GARDENS, INC.
(A Nonprofit Public Benefit Corporation)
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2002 AND 2001

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NOTE 1 - ORGANIZATION, OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES

a) Organization - Terrace Gardens, Inc. is a California Nonprofit Public Benefit organization which was incorporated in the State of California on September 12, 1986. The Corporation is governed by a nine member board of directors, one of whom must be the City Manager of the City of Milpitas, or his appointee; one of whom must be a member of the City Council of the City of Milpitas; five of whom must be residents of the City of Milpitas; and the remaining members may be selected without regard to residence.

The Board of Directors' governing authority is limited by a Regulatory Agreement, dated November 17, 1987, between Terrace Gardens, Inc. and the City of Milpitas. Significant provisions of this agreement are described in Note 2.

b) Operations - The Corporation's purpose is to develop and manage the operations of a residential complex which consists of 148 rental units, 3 guest rooms, and 2 staff units, known as Terrace Gardens, which is located in the City of Milpitas and dedicated to the needs of elderly persons.

c) Property, Equipment and Depreciation - Land contributed by the City of Milpitas is reported in the financial statements at its estimated fair market value at the date contributed as determined by the County Assessor. Land improvements, buildings, building improvements and equipment are reported at acquisition cost less accumulated depreciation. Assets are depreciated on the straight-line basis over the following estimated useful lives:

Buildings	50 years
Building improvements	10 - 50 years
Equipment	5 - 7 years

d) Income and Other Tax - The Corporation is exempt from federal income tax under section 501 (c) (3) of the Internal Revenue Code, and from California franchise tax under section 23710d of the California Revenue and Taxation Code. The Corporation is also exempt from Santa Clara County property taxes.

e) Estimates - The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

TERRACE GARDENS, INC.
(A Nonprofit Public Benefit Corporation)
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2002 AND 2001

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NOTE 1 - ORGANIZATION, OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES (Continued)

f) Basis of Presentation - The presentation of the organization's financial statements complies with Statement of Financial Accounting Standards (SFAS) No. 117, "Financial Statements of Not-for-Profit Organizations." Under SFAS No. 117, the organization is required to report information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets. All the net assets of the organization are unrestricted.

Furthermore, information is required to segregate program service expenses from support expenses. General and administrative expenses consist of a portion of management fee, office supplies, auditing, bookkeeping and accounting. The costs of providing various programs and other activities are summarized on a functional basis as follows:

Program Services	\$1,386,644
Supporting Services	
General and administrative	192,300
	<hr/>
	\$1,578,944
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NOTE 2 - REGULATORY AGREEMENT

By agreement dated November 17, 1987 with the City of Milpitas, the Corporation is:

a) Prohibited from: using the land contributed to it by the City for any purpose other than constructing and operating the Terrace Gardens residential project; encumbering the land or project by any security interest; selling, assigning, conveying or otherwise transferring its interest in the project or project site; and from discriminating in any manner against any person on account of race, marital status, sex, religious creed, ancestry, national origin or physical handicaps in connection with constructing or operating the project.

b) Required to: maintain adequate insurance coverage; indemnify and hold harmless the City of Milpitas and its officials and employees against any actual or alleged liabilities resulting from any acts or omissions of the Corporation or its employees; submit operating budgets on or before the first day of each fiscal year to the City of Milpitas

TERRACE GARDENS, INC.
(A Nonprofit Public Benefit Corporation)
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2002 AND 2001

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NOTE 2 - REGULATORY AGREEMENT (Continued)

for its approval; establish a reserve account for replacements and other project contingencies which must be funded at the rate of at least \$4,000 per month; limit occupancy in the project to persons 62 or more of age (in the case of joint occupancy at least one occupant must meet the age requirement) or 55 or more of age and handicapped; rent dwelling units by giving preference first to present elderly residents of the City of Milpitas and finally to residents of Santa Clara County not residing in Milpitas; limit rent in an amount not to exceed 30% of occupant's income, unless otherwise agreed by both the City and the Corporation, but in no event can the rent exceed the fair market rental value of the occupant's apartment (with a current minimum to maximum rent of \$304 to \$652); establish and maintain a surplus cash account, disbursements from which can only be made with the City's prior written approval and which must be disbursed to the City 30 days after receiving the City's written request for all or a portion of the surplus funds; and provide the City with annual financial statements audited by an independent certified public accountant.

<u>NOTE 3 - PROPERTY AND EQUIPMENT</u>	2002	2001
Buildings	\$ 11,400,858	\$ 11,400,858
Furniture	217,149	216,357
Office equipment	60,710	57,673
Improvements	200,423	174,668
	<hr/>	<hr/>
	11,879,140	11,849,556
Less accumulated depreciation	3,424,340	3,167,268
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	\$ 8,454,800	\$ 8,682,288
	=====	=====

NOTE 4 - CASH EQUIVALENTS AND SHORT TERM INVESTMENTS

a) Certificates of deposit totaling \$237,444 are included in cash in the accompanying financial statements. These certificates have an original maturity of three months or less and bear interest ranging from 1.04% to 2.30%.

b) Certificates of deposit totaling \$664,578 having original maturities of greater than three months are classified as short term investments in the accompanying financial statements. These certificates bear interest ranging from .85% to 2.25%.

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TERRACE GARDENS, INC.
(A Nonprofit Public Benefit Corporation)
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2002 AND 2001

NOTE 4 - CASH EQUIVALENTS AND SHORT TERM INVESTMENTS (Continued)

c) The Corporation maintains its cash balances at several financial institutions located in California. Accounts at each institution are secured by the Federal Deposit Insurance Corporation up to \$100,000. The Corporation does not have any balances exceeding the FDIC limit at December 31, 2002 and 2001.

NOTE 5 - SURPLUS CASH (DEFICIT)

Under Section 23 of its Regulatory Agreement dated November 17, 1987 with the City of Milpitas, Terrace Gardens, Inc. is required to remit surplus cash to the City upon receipt of 30 days written notice. Surplus cash is defined by that agreement as cash remaining after payment of all liabilities less amounts required for reserves and contingencies. On this basis, surplus cash as of December 31, 2002 is computed as follows:

Cash and cash equivalents	\$	349,335
Short-term Investments		664,578
Less:		
Accounts payable (operating)		(76,541)
Accrued vacation		(11,780)
Tenants security deposits		(76,354)
Long-term reserves		(400,000)
Short-term reserves		(400,000)
Operating reserve		(151,361)
Carillon Fund		(926)
Construction deficit reserve		(2,819)
Total surplus/(deficit) cash	\$	<u>(105,868)</u>

NOTE 6 - FUTURE MAJOR REPAIRS AND REPLACEMENTS

The Corporation's governing documents require funds to be accumulated for future major repairs and replacements. Accumulated funds, which aggregate approximately \$954,180 at December 31, 2002, are held in separate accounts and are generally not available for operating purposes. It is the Corporation's policy to retain the interest earned on such funds in the reserve for replacement and other contingency accounts.

TERRACE GARDENS, INC.
(A Nonprofit Public Benefit Corporation)
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2002 AND 2001

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NOTE 6 - FUTURE MAJOR REPAIRS AND REPLACEMENTS (Continued)

The Corporation engaged an independent engineer who conducted a study in April 2000 to estimate the remaining useful lives and the replacement costs of the common property components. The Corporation is funding for such major repairs and replacements over the estimated useful lives of the components based on the study's estimates of current replacement costs, considering amounts previously accumulated. Actual expenditures, however, may vary from the estimated amounts and the variations may be material. Therefore, amounts accumulated in the replacement fund may not be adequate to meet future needs.

The Corporation maintains its reserve for replacements and other contingency accounts with various financial institutions located in California. The Board of Directors has designated that the accounts be allocated as follows:

- a) Short-term reserves – Funds totaling \$400,000 with a maturity date less than three months.
- b) Long-term reserves – Funds totaling \$400,000 may have a maturity date more than three years.
- c) Operating reserves – Funds totaling \$151,361.

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TERRACE GARDENS, INC.
(A Nonprofit Public Benefit Corporation)
SUPPLEMENTARY INFORMATION ON FUTURE MAJOR REPAIRS
AND REPLACEMENTS (UNAUDITED)
DECEMBER 31, 2002

The Corporation's board of directors engaged an outside firm, Reserve Analysis Financial Planning, L.L.C. to conduct a study to estimate the remaining useful lives and the replacement costs of the components of common property. The study was completed April 11, 2000. The estimates were obtained from licensed contractors who inspected the property. Replacement costs were based on the estimated costs to repair or replace the common property components at the date of the study. Estimated current replacement costs take into account the estimated effects of inflation between the date of the study and the date the components will require repair or replacement.

The following information is based on the study and presents significant information about the components of common property. (Amounts are rounded to the nearest hundred dollars.)

Component	Estimated Remaining Useful Life (Years)	Estimated Current Replacement Cost	Designated for Repairs/Replacement December 31, 2002
Roads	5 to 39	\$ 143,800	\$ -
Concrete	2	4,500	4,500
Recreation Building	4 to 40	818,200	-
Staff Units	4 to 39	65,700	-
Tenant Units	1 to 39	2,410,900	30,000
Signage	4 to 29	4,800	-
Fencing	4 to 39	140,500	-
Electrical	24 to 29	213,300	-
Landscape	1 to 19	8,900	2,400
Common Area	1 to 29	277,000	15,000
Maintenance Allowance	2	15,000	-
Building "A"	1 to 39	81,600	-
Building "B"	1 to 39	81,000	-
Building "C"	1 to 39	67,600	-
Building "D"	4 to 39	77,300	-
Building "E"	1 to 39	78,000	-
Building "F"	1 to 39	91,100	-
Building "G"	4 to 34	401,100	-
Paint Build Exterior	5 to 10	190,700	-
Siding & Trim Replace	5 to 10	67,500	-
Construction Cost Factor	1.066%		3,161
TOTALS		\$ 5,238,500	\$ 55,061

Actual expenditures for repairs and maintenance in the Tenant Units were \$ 48,942. Actual expenditures in the Common Area were \$154,318.

TERRACE GARDENS, INC.
YEAR ENDED 12/31/2002
SUPPLEMENTAL DETAIL (p.14)

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ACTUAL EXPENSES

TENANTS' UNITS

Appliances	6,847
Carpets	10,580
Vinyl	1,076
Roof Repairs	17,790
Other	4,237
Painting	5,403
Windows	<u>3,009</u>

Subtotal Tenants Units	48,942
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COMMON AREA

Dining Room	12,262
Elevator	49,932 →
Fountain/Grounds	24,759
Kitchen Appliances	7,385
Lighting	1,248
Painting	3,803
Parking Lot / Driveway	36,750 →
Recreation	5,734
Security System	7,945
Water Heater	<u>4,500</u>

Subtotal Common Area	154,318
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Total Spending	<u><u>203,260</u></u>
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TERRACE GARDENS, INC.
(A California Nonprofit Public Benefit Corporation)

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Terrace Gardens, Inc.

We have audited the accompanying statement of financial position of Terrace Gardens, Inc., a California Nonprofit Public Benefit Corporation, as of December 31, 2003 and 2002, and the related statements of activities and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Terrace Gardens, Inc. at December 31, 2003 and 2002, and the results of its operations and its cash flows for the years then ended, in conformity with generally accepted accounting principles generally accepted in the United States of America.

Milpitas, California

February 20, 2003

TERRACE GARDENS, INC.

STATEMENTS OF FINANCIAL POSITION

December 31, 2003 and 2002

	<u>2003</u>	<u>2002</u>
<u>ASSETS</u>		
PROPERTY		
Land	\$ 1,565,277	\$ 1,565,277
Buildings and Improvements	11,601,281	11,601,281
Furnishings and equipment	277,859	277,859
Less: Accumulated Depreciation	(3,682,460)	(3,424,340)
Net property	<u>9,761,957</u>	<u>10,020,077</u>
OTHER ASSETS		
Cash - unrestricted operating	14,231	(18,203)
Cash - restricted		
Tenant security deposits	74,334	77,010
Short-term reserves	410,088	400,000
Long-term reserves	401,724	400,000
Operating reserves	102,495	151,361
Carillon fund	931	926
Construction deficit reserve	2,836	2,819
Tenants rents receivable	3,688	3,269
Deposits - Worker's Comp	3,028	1,704
Prepaid insurance	<u>46,082</u>	<u>42,774</u>
TOTAL ASSETS	<u>10,821,394</u>	<u>11,081,737</u>
<u>LIABILITIES AND NET ASSETS</u>		
LIABILITIES		
Accounts payable - trade	65,363	76,541
Accrued payroll and vacation	20,353	11,780
Tenant security deposits, including interest	74,597	77,273
Prepaid rents	283	904
Total Liabilities	<u>160,596</u>	<u>166,498</u>
NET ASSETS - UNRESTRICTED	<u>10,660,798</u>	<u>10,915,239</u>
TOTAL LIABILITIES AND NET ASSETS	<u>10,821,394</u>	<u>11,081,737</u>

See accompanying notes to these financial statements.

TERRACE GARDENS, INC.

STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS

For the years ended December 31, 2003 and 2002

	2003	2002
Income		
Gross potential rent	\$ 823,054	\$ 805,781
Guest rentals	7,140	5,540
Less vacancy loss	(7,207)	(9,599)
Net rental income	822,987	801,722
Interest income	21,627	30,328
Food service income	354,579	301,572
Other income	4,761	3,115
Total income	1,203,954	1,136,737
Operating expenses		
Administrative expense	214,013	199,831
Utilities	134,279	149,441
Operating and maintenance	275,474	372,523
Taxes and insurance	186,104	163,448
Food service contract	359,994	371,148
Recreation	47,578	65,482
Total operating expenses	1,217,442	1,321,872
Depreciation	258,120	257,072
Total expenses	1,475,562	1,578,944
Decrease in net assets	(271,609)	(442,208)
Unrestricted net assets - Beginning of year	10,915,239	11,357,447
Prior Period Adjustments	17,168	-
Unrestricted net assets - End of year	10,660,798	10,915,239

See accompanying notes to these financial statements.

TERRACE GARDENS, INC.

STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS (Continued)

For the years ended December 31, 2003 and 2002

	2003	2002
<u>Administrative expenses</u>		
Advertising	\$ 556	\$ 2,110
Office Salaries	59,280	53,894
Office Supplies	18,967	18,502
Management fee	46,281	46,240
Manager's salary	57,463	49,652
Audit fee	4,500	4,000
Legal & Accounting	14,548	13,583
Telephone and answering service	7,605	8,555
Seminars and training	1,449	1,460
Miscellaneous administrative	3,364	1,835
Total administrative expenses	<u>\$ 214,013</u>	<u>\$ 199,831</u>
<u>Utilities</u>		
Electricity	69,706	94,149
Water	29,563	37,173
Gas	23,924	11,172
Sewer	11,086	6,947
Total utilities	<u>\$ 134,279</u>	<u>\$ 149,441</u>
<u>Operating and maintenance</u>		
Janitor payroll	45,339	43,114
Janitor and cleaning	12,135	17,838
Exterminating	4,065	7,431
Trash removal	18,527	18,226
Security	9,315	8,573
Grounds contract and supplies	19,015	20,114
Repairs payroll	69,750	72,886
Repairs materials	16,497	13,818
Repairs contracts	31,128	146,309
Plumbing maintenance	13,988	1,965
Electrical maintenance	11,633	1,252
Elevator maintenance	8,876	9,321
Heating and cooling repairs	10,360	10,020
Painting contract and supplies	4,846	1,655
Total operating and maintenance	<u>\$ 275,474</u>	<u>\$ 372,523</u>

See accompanying notes to these financial statements.

TERRACE GARDENS, INC.

STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS (Continued)

For the years ended December 31, 2003 and 2002

	<u>2003</u>	<u>2002</u>
<u>Taxes and insurance</u>		
Real estate taxes - special assessments only	\$ 6,515	\$ 8,635
Payroll taxes	\$ 23,045	22,218
Miscellaneous licenses and permits	582	443
Property and liability insurance	100,737	78,824
Workers' compensation	31,437	23,770
Health insurance and other employee benefits	23,788	29,559
Total taxes and insurance	<u>\$ 186,104</u>	<u>\$ 163,448</u>
 <u>Food service contract</u>		
Food	359,994	371,148
Total food service contract	<u>\$ 359,994</u>	<u>\$ 371,148</u>
 <u>Recreation expense</u>		
Salary	20,394	31,357
Supplies	6,008	13,955
Service coordinator salary	16,425	14,394
Miscellaneous recreation expense	4,751	5,775
Total recreation expense	<u>\$ 47,578</u>	<u>\$ 65,482</u>

See accompanying notes to these financial statements.

TERRACE GARDENS, INC.

STATEMENTS OF CASH FLOWS

For the years ended December 31, 2003 and 2002

	<u>2003</u>	<u>2002</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Decrease in net assets	\$ (254,441)	\$ (442,208)
Adjustments to reconcile decrease in net assets to net cash provided by operating activities:		
Depreciation	258,120	257,072
Decrease / (Increase) in current assets		
Tenant rents receivable	(419)	(3,118)
Prepaid insurance and taxes	(4,633)	(5,808)
Increase / (Decrease) in current liabilities		
Accounts payable	(11,178)	(32,188)
Prepaid rents	(621)	834
Security deposits	(2,676)	2,138
Accrued vacation	8,573	5,701
Net cash provided by operating activities	<u>\$ (7,275)</u>	<u>\$ (217,577)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Building Improvements	(0)	(25,755)
Property & equipment additions	(0)	(3,829)
Restricted cash accounts	39,709	225,584
Net cash used in investing activities	<u>\$ 39,709</u>	<u>\$ 196,000</u>
INCREASE / (DECREASE) IN UNRESTRICTED CASH	\$ 32,434	\$ (21,577)
UNRESTRICTED CASH AT BEGINNING OF YEAR	(18,203)	3,374
UNRESTRICTED CASH AT END OF YEAR	<u>\$ 14,231</u>	<u>\$ (18,203)</u>

See accompanying notes to this financial statement.

TERRACE GARDENS, INC.
(A Nonprofit Public Benefit Corporation)
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2003 AND 2002

NOTE 1 - ORGANIZATION, OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES

a) Organization - Terrace Gardens, Inc. is a California Nonprofit Public Benefit organization which was incorporated in the State of California on September 12, 1986. The Corporation is governed by a nine member board of directors, one of whom must be the City Manager of the City of Milpitas, or his appointee; one of whom must be a member of the City Council of the City of Milpitas; five of whom must be residents of the City of Milpitas; and the remaining members may be selected without regard to residence.

The Board of Directors' governing authority is limited by a Regulatory Agreement, dated November 17, 1987, between Terrace Gardens, Inc. and the City of Milpitas. Significant provisions of this agreement are described in Note 2.

b) Operations - The Corporation's purpose is to develop and manage the operations of a residential complex which consists of 148 rental units, 3 guest rooms, and 2 staff units, known as Terrace Gardens, which is located in the City of Milpitas and dedicated to the needs of elderly persons.

c) Property, Equipment and Depreciation - Land contributed by the City of Milpitas is reported in the financial statements at its estimated fair market value at the date contributed as determined by the County Assessor. Land improvements, buildings, building improvements and equipment are reported at acquisition cost less accumulated depreciation. Assets are depreciated on the straight-line basis over the following estimated useful lives:

Buildings	50 years
Building improvements	10 - 50 years
Equipment	5 - 7 years

d) Income and Other Tax - The Corporation is exempt from federal income tax under section 501 (c) (3) of the Internal Revenue Code, and from California franchise tax under section 23710d of the California Revenue and Taxation Code. The Corporation is also exempt from Santa Clara County property taxes.

e) Estimates - The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

TERRACE GARDENS, INC.
(A Nonprofit Public Benefit Corporation)
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2003 AND 2002

NOTE 1 - ORGANIZATION, OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES (Continued)

f) Basis of Presentation – The presentation of the organization's financial statements complies with Statement of Financial Accounting Standards (SFAS) No. 117, "Financial Statements of Not-for-Profit Organizations." Under SFAS No. 117, the organization is required to report information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets. All the net assets of the organization are unrestricted.

Furthermore, information is required to segregate program service expenses from support expenses. General and administrative expenses consist of a portion of management fee, office supplies, auditing, bookkeeping and accounting. The costs of providing various programs and other activities are summarized on a functional basis as follows:

Program Services	\$1,252,033
Supporting Services	
General and administrative	223,529
	<hr/>
	\$1,475,562
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NOTE 2 - REGULATORY AGREEMENT

By agreement dated November 17, 1987 with the City of Milpitas, the Corporation is:

a) Prohibited from: using the land contributed to it by the City for any purpose other than constructing and operating the Terrace Gardens residential project; encumbering the land or project by any security interest; selling, assigning, conveying or otherwise transferring its interest in the project or project site; and from discriminating in any manner against any person on account of race, marital status, sex, religious creed, ancestry, national origin or physical handicaps in connection with constructing or operating the project.

b) Required to: maintain adequate insurance coverage; indemnify and hold harmless the City of Milpitas and its officials and employees against any actual or alleged liabilities resulting from any acts or omissions of the Corporation or its employees; submit operating budgets on or before the first day of each fiscal year to the City of Milpitas

TERRACE GARDENS, INC.
(A Nonprofit Public Benefit Corporation)
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2003 AND 2002

NOTE 2 - REGULATORY AGREEMENT (Continued)

for its approval; establish a reserve account for replacements and other project contingencies which must be funded at the rate of at least \$4,000 per month; limit occupancy in the project to persons 62 or more of age (in the case of joint occupancy at least one occupant must meet the age requirement) or 55 or more of age and handicapped; rent dwelling units by giving preference first to present elderly residents of the City of Milpitas and finally to residents of Santa Clara County not residing in Milpitas; limit rent in an amount not to exceed 30% of occupant's income, unless otherwise agreed by both the City and the Corporation, but in no event can the rent exceed the fair market rental value of the occupant's apartment (with a current minimum to maximum monthly rent of \$324 to \$685); establish and maintain a surplus cash account, disbursements from which can only be made with the City's prior written approval and which must be disbursed to the City 30 days after receiving the City's written request for all or a portion of the surplus funds; and provide the City with annual financial statements audited by an independent certified public accountant.

<u>NOTE 3 - PROPERTY AND EQUIPMENT</u>	<u>2003</u>	<u>2002</u>
Buildings	\$ 11,400,858	\$ 11,400,858
Furniture	217,149	217,149
Office equipment	60,710	60,710
Improvements	200,423	200,423
	<u>11,879,140</u>	<u>11,879,140</u>
Less accumulated depreciation	3,682,460	3,424,340
	<u>\$ 8,196,680</u>	<u>\$ 8,454,800</u>
	=====	=====

NOTE 4 - CASH EQUIVALENTS AND SHORT TERM INVESTMENTS

Cash and cash equivalent assets totaled \$1,006, 638. These instruments consisted of:

- a) Cash, operating accounts, and certificates of deposits with a maturity of 3 months or less totaled \$440,337, and earned interest ranging from 0.25% to 0.85%.
- b) Certificates of deposit with a maturity date greater than three months from the December 31, 2003 totaled \$566,301, and bore interest ranging from 0.95% to 1.4%.

TERRACE GARDENS, INC.
(A Nonprofit Public Benefit Corporation)
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2003 AND 2002

NOTE 4 - CASH EQUIVALENTS AND SHORT TERM INVESTMENTS (Continued)

c) The Corporation maintains its cash balances at several financial institutions. Accounts at each institution are secured by the Federal Deposit Insurance Corporation up to \$100,000. All except one of the accounts have a balance exceeding \$100,000 at December 31, 2003. This U.S Bank of California Account totaled \$110,087.80 as of 12/23/2003. This account which was expected to be rolled over after maturity, was inadvertently estated to the State of California by the bank. However, this error has since been corrected, and the full amount is reflected in the financial statements.

NOTE 5 - SURPLUS CASH (DEFICIT)

Under Section 23 of its Regulatory Agreement dated November 17, 1987 with the City of Milpitas, Terrace Gardens, Inc. is required to remit surplus cash to the City upon receipt of 30 days written notice. Surplus cash is defined by that agreement as cash remaining after payment of all liabilities less amounts required for reserves and contingencies. On this basis, surplus cash as of December 31, 2003 is computed as follows:

Cash and cash equivalents	\$ 440,337
Short-term Investments	566,301
Less:	
Accounts payable (operating)	(65,363)
Accrued payroll and vacation	(20,353)
Tenants security deposits	(74,597)
Long-term reserves	(401,724)
Short-term reserves	(410,088)
Operating reserve	(102,495)
Carillon Fund	(931)
Construction deficit reserve	(2,836)

Total surplus/(deficit) cash	\$ (71,749)
	=====

TERRACE GARDENS, INC.
(A Nonprofit Public Benefit Corporation)
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2003 AND 2002

NOTE 6 -- PRIOR PERIOD ADJUSTMENTS

Internal monthly transfers of \$8,479/month to fund replacement reserves for November and December 2002 was incorrectly reflected as accounts payable in the prior year. This overstated accounts payable by \$16,958.16 last year. Reversal of this entry along with several uncleared payment checks made up the prior period adjustment of \$17,168.

NOTE 7 - FUTURE MAJOR REPAIRS AND REPLACEMENTS

The Corporation's governing documents require funds to be accumulated for future major repairs and replacements. Accumulated funds, which aggregate approximately \$914,307 at December 31, 2003, are held in separate accounts and are generally not available for operating purposes. It is the Corporation's policy to retain the interest earned on such funds in the reserve for replacement and other contingency accounts.

The Corporation in 2003 engaged an independent engineer to update the April 2000 reserve study to estimate the remaining useful lives and the replacement costs of the common property components. The new study is yet to be adopted by the Board of Directors.

The Corporation is expected to continue funding such major repairs and replacements over the estimated useful lives of the components based on the new study's estimates of current replacement costs, considering amounts previously accumulated. Actual expenditures, however, may vary from the estimated amounts and the variations may be material. Efforts are underway by management to ensure sufficient funds are set aside to meet repairs and replacements identified in the updated reserve study.